SUPREME COURT, U. S.
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MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-852

GRAYCO CONSTRUCTORS, INC., and
SEABOARD SURETY COMPANY,

Petitioners,

vs.

GREAT LAKES GAS TRANSMISSION COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

DONALD V. O'BRIEN
THOMAS R. NEWMAN
Counsel for Petitioners

39 South LaSalle Street
Chicago, Illinois 60603
(312) FR 2-1462

JOSEPH BLEICH,
CHARLES F. MCGUIRE,
WALTER E. TRITTIPO, JR.,
JAMES R. HALE,
Of Counsel.

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No. 74-

GRAYCO CONSTRUCTORS, INC., and
SEABOARD SURETY COMPANY,

Petitioners,

vs.

GREAT LAKES GAS TRANSMISSION COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered on November 8, 1974, which unanimously affirmed the judgment entered in the United States District Court for the Western District of Michigan on May 16, 1973, in favor of plaintiff-respondent, Great Lakes Gas Transmission Company, in the amount of $1,838,544.56.

Opinions Below

The opinion of the United States Court of Appeals for the Sixth Circuit (Appendix A) is not yet reported. The opinion of the trial court granting respondent's motion for an order excluding all testimony regarding rate increases allowed or possibly allowable to Great Lakes on the basis of the change in its accounting method (Appendix B) is not reported.

Jurisdiction

The judgment of the United States Court of Appeals for the Sixth Circuit was entered on November 8, 1974.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

In this diversity action plaintiff-respondent Great Lakes Gas Transmission Company (herein Great Lakes) sued defendants-petitioners Grayco Constructors, Inc. (herein Grayco), a pipeline contractor, and Seaboard Surety Company, the surety on Grayco's performance bond, to recover damages it allegedly sustained as the result of two ruptures which occurred in the section of pipeline built by Grayco shortly after the work was completed and the pipeline placed into service.

The transportation and distribution of natural gas is subject to federal regulation (see 15 U.S.C. §717 *et seq.*) and the rates that Great Lakes is permitted to charge and the accounting procedures it may employ are controlled and prescribed by the Federal Power Commission.

When Great Lakes assumed possession of the line on November 1, 1968, it changed its accounting procedures

from an "under construction" mode to an "in-service" mode.* Subsequently, after the two ruptures occurred, Great Lakes reversed its accounting entries as of November 1, 1968, and reverted to the "under construction" method until May 29, 1969.

As a result of this reversion, Great Lakes was able to capitalize the entire cost of repairs to the line as well as other items, such as interest expense, which would normally have been charged as expenses deductible from income. The increase in the capital account became a part of Great Lakes' rate base upon which the allowable rates that Great Lakes was permitted to charge its customers were determined.

This change in its accounting posture, permissible under the Federal Power Commission regulations, has enabled Great Lakes to enhance its revenues by $2,245,064 as of December 31, 1974. With no further change in circumstance, and on the basis of the present allowable rate, Great Lakes will realize an additional $6,376,994 over the remaining useful life of the pipeline.

It was petitioners' contention at trial that the rates Great Lakes was permitted to charge on the basis of the extraordinarily capitalized costs following reversion to the "under construction" mode of accounting were far in excess of the rates otherwise allowable, and that, in fact, they exceeded the amount of damages allegedly sustained by Great Lakes as the result of the accidental rupture of the line. But for the accidents, Great Lakes would not have been able to revert from the "in-service" to "under con-

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* When an entity is "under construction" all of its costs and expenditures are accumulated in a capital account and treated as investments. Once it is "in service" as an operating entity, its costs and expenditures are charges against income, not capital contributions.

struction" mode of accounting and would not realize the additional $8,622,058 heretofore described.

The trial court precluded petitioners from showing that respondent had completely mitigated its damages. It excluded all evidence tending to show that by reason of the change in its capital account Great Lakes was able to increase its revenues to such a degree that it could be found to have financially benefited rather than lost as a result of the accidents.

The following questions are presented:

1. In an ordinary negligence and breach of contract action such as this, where defendant Grayco was not charged with any deliberate, wanton or illegal conduct which might justify, on public policy grounds, the imposition of exemplary damages as a deterrent, should the passing-on defense not have been available to it?

2. Are the recognized rules of law which require an injured party to mitigate its damages and provide for a balancing of the benefit conferred by the allegedly tortious act against the damage caused thereby inapplicable merely because the plaintiff operates in an industry where its rate structure is subject to federal regulation?

3. In this diversity action involving no special federal interest, where the cause of the pipeline ruptures was sharply controverted, does Rule 43(a) of the Federal Rules of Civil Procedure, the so-called "maximum admissibility" rule, justify the introduction into evidence of highly prejudicial hearsay conclusions as to the cause of the ruptures contained in an order of the Department of Transportation, Office of Pipeline Safety, which are inadmissible under the controlling state authorities?

4. Were the trial court's instructions limiting the use which the jury could properly make of this hearsay evidence sufficient to overcome the prejudicial effect of its admission?

Statement

The breaks in the line

In the spring of 1968 Grayco began work on a 60-mile section of Great Lakes' natural gas pipeline running from eastern Wisconsin into the upper peninsula of Michigan. The work was substantially completed by late October and Great Lakes assumed beneficial occupancy of the Grayco section on November 1, 1968.

On December 27, 1968, the line suddenly ruptured causing approximately 850 feet of pipe to be split and thrown out of the ground. Repairs were completed by January 10, 1969, and the line was repressured. A few hours later the line ruptured again, this time at a point nearly three miles west of the first rupture. Repairs on the second line break were completed on January 17, 1969, and the line was restored to operation.

As a result of these two ruptures, the United States Department of Transportation ordered the operating pressure reduced pending satisfactory proof that similar breaks would not occur. An internal examination, known as a Linalog survey, was made of the line and on May 29, 1969, all pressure restrictions were lifted and the line began operating as planned.

Great Lakes' alleged damages

Plaintiff submitted a total damage claim of $2,444,193.94 to the jury. It contended that it expended $383,993.94 in repairing the line; it lost $25,591.00 worth of gas which escaped from the line at the time of the ruptures; and the Linalog survey cost $140,000.00. Its total expenses amounted to $549,584.94.

In addition, plaintiff claimed that it lost revenue in the amount of $1,894,609.00 during the period of total incapacity of the line from December 27, 1968 to January 17, 1969, and the period of partial incapacity from January 17, 1969 until May 29, 1969, while pressures were restricted.

The jury, rejecting a portion of this claim, returned a verdict in favor of plaintiff in the amount of $1,838,544.56.

Great Lakes' accounting treatment which enabled it to completely mitigate its loss

When Great Lakes placed the line in operation on November 1, 1968, it transferred approximately $184,000,000.00 from its "construction work in progress account" to another asset account entitled "gas plant in service." The "gas plant in service" account, under the Federal Power Commission's regulations, is a critical factor in determining Great Lakes' rate base.

After the ruptures occurred, Great Lakes, in accordance with the rules and regulations of the Federal Power Commission and the uniform system of accounts, took the position that it had mistakenly put its plant into service as of November 1, 1968, but that in fact its plant was not

ready for service until the pressure restrictions were lifted on May 29, 1969. Accordingly, it reversed the entries in its books and records and reverted to a "construction work in progress" mode of accounting until May 29, 1969.

The effect of this reversion was to place all of Great Lakes' costs during the period of repairs and pressure restrictions into its plant account, which in turn was used to determine its rates. Specifically, Great Lakes was able to capitalize the cost of repairs, as well as millions of dollars in interest paid between November 1, 1968, and the end of May, 1969, property taxes, professional fees, and all other items of expense which otherwise would have constituted an operating loss or charge against income.

In addition, under the then prevailing Federal Power Commission regulations, plaintiff was required to depreciate its plant in service at the rate of 3% per annum. No such depreciation, however, was required to be taken against capital expended for the gas plant so long as it was being carried as "construction work in progress." This meant that the plant was not diminished by more than three million dollars in depreciation as of May 29, 1969.

The net result of these changes in accounting treatment, available to Great Lakes only by reason of the two line breaks, was to increase the "gas plant in service" account by approximately $8 million, which, because of the way rates are set, will be returned to Great Lakes over the life of the line together with a reasonable return thereon.

In view of the foregoing, petitioners sought to show that in the long run Great Lakes actually profited by the occurrence of the line breaks which made an extension of the "construction work in progress" status possible, that any damage which might have been sustained became

not a loss, but an increase in the plant which would be fully recaptured by rate increases attributable to it. By its ruling, the trial court precluded petitioners from establishing this defense.

Great Lakes' settlement with the Federal Power Commission

Among the reasons advanced for excluding the proffered proof as to plaintiff's double recovery, the courts below asserted that the alleged benefit is conjectural and speculative. While we believe that this more properly relates to the weight and sufficiency of the evidence and not its admissibility, we shall address ourselves to the courts' point.

We ask this Court to take judicial notice* of an "Order Approving Settlement Agreement" issued by the Federal Power Commission on November 21, 1973, in the matter of Great Lakes Gas Transmission Company, Docket No. RP73-4, which order specifically approved, *inter alia,* the following provision of the Settlement Agreement between Great Lakes and the Federal Power Commission pertaining to "the issue of adjustments to original cost of Great Lakes plant as a result of a Commission audit which was ordered in Docket RP71-102":

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* In *New York Indians* v. *United States,* 170 U.S. 1, 32 (1898), this Court held that it could take judicial notice of documents emanating from the executive and legislative departments of the government even though they were not called to the attention of the court below. The order of the Federal Power Commission, the Settlement Agreement and the Schedules annexed thereto are, we submit, public documents which are a proper matter of judicial cognizance.

"(3) *Article III*—Great Lakes agrees to make original cost adjustments and other accounting entries as set forth on Schedule No. 1 of Appendix D appended to the Stipulation and Agreement. More specifically it is agreed that:

(a) An in-service date for the Phase II facilities will be January 31, 1969, [instead of November 1, 1968] and the amounts in rate base related to such facilities for the period January 1, to May 31, 1969, shall be amortized over a 10 year period commencing November 15, 1971. Any reduction of income taxes as a result of higher tax base due to the above adjustment will be flowed-through to operating income."

Before turning to a consideration of the actual dollar benefit that accrued to Great Lakes upon approval of the Settlement Agreement, it should be noted that the Federal Power Commission intended and expressly agreed that upon issuance of the Commission's order approving the agreement

> *"neither the Commission, its Staff, nor any party to this proceeding will raise any question respecting the propriety of the original cost of Great Lakes' gas plant up to December 31, 1970,* reflected in the cost of service shown in Appendix A *or of the accounting entries* shown in Appendix D. In this regard, it is specifically stipulated and agreed that the in-service date for Great Lakes' Phase II facilities is January 31, 1969, and that the amounts shown on Schedule 1 of Appendix D associated with the change of in-service date for the Phase II facilities from May 31, 1969, to January 31, 1969, shall be amortized over a ten-year period commencing

> November 15, 1971, as shown on and in accordance with the amortization schedule set forth on Schedule 5 of Appendix D." (emphasis added, Stipulation and Agreement in Settlement of Rate Proceedings, F.P.C. Docket No. RP73-4, Art. III, pp. 6-7).

On the basis of the data available in the Federal Power Commission file (Docket Nos. RP71-102 and RP73-4), including the Settlement Agreement and Schedules appended thereto, we have prepared an analysis (annexed hereto as Appendix C, Schedules 1-4) showing that as a result of the line breaks, the in-service date for Phase II facilities being initially considered to be May 31, 1969 and finally January 31, 1969, rather than November 1, 1968, and the resulting accounting changes, Great Lakes has been permitted to recover $2,245,064 to December 31, 1974, and may reasonably expect to receive an additional $6,376,994 over the remaining life of the pipeline, more than 4 times the amount of the judgment.

The prejudice arising from the admission of hearsay findings of fact contained in the Department of Transportation order

Plaintiff offered evidence of surface scratches or gouges on the pipe at the location of both ruptures. There was testimony based on certain metallurgical phenomena that these gouges (.010 and .024 inches deep in the .375 inches thick steel pipe wall) were a proximate cause of the ruptures.

The origin and cause of the surface damage to the pipe in each instance provided the central liability issue in the trial. Plaintiff conceded that there was no direct evidence of any specific incident or occurrences of damage to the pipe in these areas by defendant or anyone else.

Plaintiff's experts gave it as their opinion (which petitioners challenged as inadmissible in the courts below) that the gouging could have been inflicted by the pipe having been struck by some piece of heavy construction equipment such as that used by Grayco.

The error of which we complain at this time was the admission into evidence of the Department of Transportation order imposing pressure restrictions following the two line breaks. This order contained "findings of fact" which were clearly inadmissible hearsay and which expressed the conclusion that the pipeline had been damaged during the course of construction.

While conceding that the pressure restriction contained in the order was relevant and admissible, petitioners' counsel objected to a reading of the entire order, including the hearsay opinion or conclusion. Over objection, the entire document was read and given to the jury during its deliberations.

The effect of this evidence was to make it appear as though the otherwise unsupported opinions of plaintiff's experts were corroborated and unimpeachably supported by the combined judgment of two agencies of the United States and one agency of the State of Michigan.

We submit that the trial court's instructions to the jury as to how they should regard the hearsay portion of the document were incapable of overcoming the prejudice to petitioners. In the oft-quoted words of Mr. Justice Jackson, "The naive assumption that prejudicial effects can be overcome by instructions to the jury, . . . all practicing lawyers know to be unmitigated fiction" (*Krulewitch* v. *United States*, 336 U.S. 440, 453 (1949), concurring opinion).

Reasons for Granting the Writ

1. This Court has written that "A fundamental requirement of due process is 'the opportunity to be heard' . . . at a meaningful time and in a meaningful manner" (*Armstrong* v. *Manzo*, 380 U.S. 545, 552 (1965)). In the context of an ordinary negligence and breach of contract action such as the case at bar, the "opportunity to be heard . . . in a meaningful manner" must include the opportunity for the defendant to interpose all available defenses to the cause of action as a whole and by way of mitigation of damages. Petitioners were deprived of that opportunity by the rulings of the courts below.

The settled law of Michigan, which governs this diversity action, recognizes the "balancing benefit rule" for ascertaining the true measure of damages in a tort action (*e.g.*, *Burtraw* v. *Clark*, 103 Mich. 383, 61 N.W. 552 (1894); *Johnstone* v. *Detroit, Grand Haven & Milwaukee Ry. Co.*, 245 Mich. 65, 222 N.W. 325 (1928); *Troppi* v. *Scarf*, 31 Mich. App. 240, 187 N.W.2d 511 (1971)). The rule is described in McCormick, *Damages* §40 (1935), as follows:*

> "Where the defendant's wrong or breach of contract has not only caused damage, but has also conferred

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* In connection with the trial court's belief that creation of the opportunity for benefit alone is not sufficient, the following statement from McCormick, *Damages* §40, is applicable:

> "Closely akin to, but not entirely identical with, the doctrine of avoidable consequences, is the principle that, in arriving at damages for defendant's wrongful conduct, if any benefit, *or opportunity for benefit*, appears to have accrued to the plaintiff by reason of defendant's breach of duty, a balance must be struck between benefit and loss, and the defendant should be charged only with the difference—the net loss." (Emphasis added).

> a benefit upon plaintiff . . . which he would not otherwise have reaped, the value of this benefit must be credited to defendant in assessing the damages."

This principle is, of course, founded on the sound logic that ordinary common-law negligence and breach of contract cases involve only compensatory damages and are calculated to put the plaintiff in the same position he would have been in had the damage not occurred.

Michigan has recognized that the defendant in a negligence action may show by way of mitigation of damages that the plaintiff has "passed-on" some or all of his claimed loss. Thus, in *Detroit & Cleveland Nav. Co.* v. *The Elbert H. Gary,* 161 F. Supp. 570, 577 (E.D. Mich. 1958), affd 264 F.2d 247 (6th Cir. 1959), libelant's dock was taken in condemnation proceedings by the City of Detroit. This taking was on appeal at the time respondent admittedly damaged the dock. The court held that libelant had sustained no compensable loss where the full condemnation award was paid subsequent to its affirmance in the condemnation appeal. In effect, the damage to the dock was passed on to the public.*

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* To be sure, in certain types of cases the "passing-on" defense has been disallowed as an exception to the general rule. (*e.g. Hanover Shoe, Inc.* v. *United Shoe Machinery Co.,* 392 U.S. 481 (1968); *United States* v. *Borden,* 347 U.S. 514 (1954); *Southern Pacific Co.* v. *Darnell-Taenzer,* 245 U.S. 531 (1918). See generally, Pollock, *Automatic Treble Damages and the Passing On Defense: The Hanover Shoe Decision,* 13 The Antitrust Bulletin 1183 (1968).

These, however, are cases which involve at least two major considerations which distinguish them from the case at bar. The first is that the purpose of the exception is the overriding public policy to deter, to prevent *in futuro,* by exemplary punishment, certain types of *illegal* conduct. The second is the well recognized place of such a deterrent in the enforcement scheme of legislative economic policy.

The same principle has been applied to reduce or eliminate plaintiffs' recoveries in breach of contract cases. See, *e.g., Westland Construction Co.* v. *Chris Berg, Inc.*, 35 Wash.2d 824, 215 P.2d 683 (1950), *Superwood Corp.* v. *Lanson-Stang, Inc.*, 311 F.2d 735 (8th Cir. 1963), *Farrey's, Inc.* v. *Supplee-Biddle Hardware Co.*, 103 F.Supp. 488 (E.D. Pa., 1952); *Karzen* v. *Heitzmann*, 86 N.W. 2d 514 (No. Dak., 1957).

This Court has recognized that where proof of "passing-on" is uncomplicated, and there are no policy considerations that would bar the defense, the defense may be allowed. Thus, in *Hanover Shoe, Inc.* v. *United Shoe Machinery Co.*, 392 U.S. 481, 494 (1968), the Court wrote:

> "We recognize that there might be situations—for instance, when an overcharged buyer had a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged—where the considerations requiring that the passing-on defense not be permitted in this case would not be present."

As noted above, Grayco was and is prepared to demonstrate mathematically the substantial monetary benefit that has already accrued to Great Lakes by reason of the change in its mode of accounting which followed, and was made possible only by reason of, the two pipelines ruptures.

Our analysis shows that Great Lakes has already recouped far in excess of the amount of the jury's verdict and that it may reasonably expect to receive an additional $6,376,994 in benefits during the useful life of the line. There is nothing complicated or speculative with respect to the proof of benefits already received by Great Lakes as of December 31, 1974—$2,245,064.

The decision below marks the first time that a defendant in a simple negligence and breach of contract action,

involving no charges of deliberate, wanton or illegal conduct, has been deprived of the opportunity to make proof that plaintiff completely mitigated its damages. Such an unwarranted limitation on petitioners' right to mount a meaningful defense to plaintiff's multi-million dollar action against it is unprecedented and unjust. It presents a novel and substantial question of law for this Court to review.

Finally, petitioners have been deprived of their defenses solely by reason of the fortuitous circumstance that plaintiff commenced its action in the federal court. The authorities cited above show that the "balancing benefit rule" and the "passing-on" defense would both have been available to the defendants had this action been tried in the state court. The choice of forum should not carry with it such a drastic change in the substantive rules of law.

2. The controlling Michigan authority, *Derrick* v. *Blazers,* 355 Mich. 176, 93 N.W.2d 909, 69 A.L.R.2d 1143 (1959), plainly mandates exclusion of the hearsay portions of the Department of Transportation order to which petitioners objected so strenuously. In that case, the matter which evoked a reversal by the Michigan Supreme Court were the opinions and conclusions of an investigating police officer who had no personal knowledge of the facts. Justice Edwards, writing for a unanimous court, adopted with approval the language from *Jones on Evidence* (2d ed.) Section 1242, (355 Mich. at p. 181):

> "If it were a general rule of procedure that witnesses might be allowed to state not only those matters of fact about which they are supposed to have knowledge, but also the opinions they might entertain about the facts in issue, or the impression made upon them by or conclusions of inferences to be drawn from such facts, the administration of justice would become less than a farce."

Recognizing the tendency of lay jurors to give disproportionate weight to any evidence, however tenuous, which has the stamp of "official" sanction, the *Derrick* court concluded its opinion with the observation that the admonition of the trial judge to the jury to disregard hearsay and opinions would not cure the prejudicial effect of the inadmissible evidence.*

The question which we ask this Court to consider in the exercise of its supervisory power over the lower federal courts is whether Rule 43(a) of the Federal Rules of Civil Procedure nullifies settled state law barring the admission of such highly prejudicial hearsay? Whether in this diversity action involving no special federal interest, Rule 43(a) and the supposed curative instructions given by the trial court render admissible matter that would have been excluded had this action been tried in the state courts?

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* The cases collected in the Annotation, 69 A.L.R. 2d 1148, reflect the almost uniform acceptance and application by courts throughout the United States of the reasoning of the Michigan Supreme Court in *Derrick*. See also *Titus* v. *State Tax Commission*, 374 Mich. 476, 132 N.W. 2d 647 (1965), in which the "official" nature of a City resolution and a citizen's committee report did not cure the inadmissible, hearsay nature of its content.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Dated: January 10, 1975.

Respectfully submitted,

DONALD V. O'BRIEN,
THOMAS R. NEWMAN,
Counsel for Petitioners.

JOSEPH BLEICH,
CHARLES F. MCGUIRE,
WALTER E. TRITTIPO, JR.,
JAMES R. HALE,
Of Counsel.

[APPENDICES FOLLOW]

APPENDIX A

Decision of the United States Court of Appeals for the Sixth Circuit

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 73-1948

GREAT LAKES GAS TRANSMISSION CO.,
Plaintiff-Appellee,

v.

GRAYCO CONSTRUCTION, INC., AND SEABOARD SURETY COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for The Western District of Michigan, Northern Division.

Decided and Filed November 8, 1974.

Before: PHILLIPS, Chief Judge, WEICK, Circuit Judge, and WALINSKI,* District Judge.

WALINSKI, District Judge. This is an appeal from a verdict and judgment of $1,838,544.56, recovered by plain-

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* The Honorable Nicholas J. Walinski, Judge of the United States District Court for the Northern District of Ohio, sitting by designation.

tiff from the company to whom it had awarded a contract to construct part of its pipeline project. After the work was completed and the pipeline had been placed in service, the pipeline ruptured for substantial distance on two separate occasions, thereby causing damages which required repairs and which resulted in loss of revenue.

On this appeal, error is charged in the admission of certain opinion evidence and in the rejection by the Court of evidence which would show that plaintiff had recovered substantial benefits in its rate allowance by changing its accounting procedure whereby the loss was passed on to plaintiff's customers. Appellants also assign as error the lack of competent evidence to support the verdict on the issues of negligence and breach of warranty; that plaintiff's witness improperly construed the contract between plaintiff and its gas supplier; that the verdict is excessive; and that defendant was prejudiced by the trial court's jury charge. We find it necessary only to discuss the first two contentions.

Plaintiff is a Delaware corporation which was formed as a joint venture by two major North American natural gas distributing and pipeline companies: TransCanada Pipelines, Ltd., and American Natural Gas Company. The company was formed to build and operate a new and larger gas pipeline to extend across northern Minnesota, Wisconsin, the upper peninsula of Michigan, and through the lower peninsula to Sarnia, Michigan, where it would connect with Trans-Canada's facility at the international boundary. The construction of the line was divided into two phases, the first of which was completed in 1967 and ran from Sarnia to Farwell, Michigan. The second phase began in 1968 and involved several pipeline construction companies, one of whom was the defendant.

Appendix A

Defendant Grayco entered into a contract with plaintiff in which Grayco was to build a 60-mile section of the pipeline running from eastern Wisconsin into the upper peninsula of Michigan. Grayco's obligation extended from unloading the pipe from railroad cars; clearing and excavating the land; welding pipe sections together; cleaning, priming and coating the pipe; laying the pipe into the ground and filling in the trench; final testing and purging of the pipeline; and "all things necessary to completely construct a gas transmission facility ready to be operated * * *." (Pl. Ex. No. 2.) The steel pipe used in the line was, under the contract, to be capable of withstanding pressures of 65,000 pounds per square inch without rupturing or being deformed.

Grayco began work in the spring of 1968 and was to complete the section by November 1, 1968. Work was substantially finished by late October, 1968, in spite of unusually wet and cold weather which began in September. As part of its testing procedures, Grayco performed a hydrostatic test of the pipeline at pressures up to 105% of the specified strength with the pressure maintained for a 24-hour period. These tests were successful at the two sites with which we are here concerned, the pipe surviving long tests in excess of 100% of the specified minimum strength. Great Lakes assumed beneficial occupancy of the Grayco section by November 1, 1968, although certain rough cleanup work continued until severe weather conditions forced a halt to this activity on November 13, 1968.

Great Lakes began gradually after November 1, 1968, to build up the pressure in its new line to the allowable maximum. In spite of some "start-up" problems in the first weeks, the pipeline was operating by mid-December so as to enable Great Lakes to meet the requirements of certain gas transmission contracts.

However, on December 27, 1968, the line suddenly ruptured at milepost 403.2 (measured as 403.2 miles from the western terminus of the line) causing approximately 850 feet of pipe to be split and violently thrown out of the ground. Great Lakes immediately began repairs using Grayco equipment which had been stored in the vicinity for the winter. By January 10, 1969, the line had been completely repaired and gas pressure was gradually increased.

Great Lakes' tranquility was to be short-lived, however. A few hours after gas transmission had resumed, the line ruptured again, this time at milepost 400.2 (nearly three miles west of the first rupture). Approximately 380 feet of pipe was split and thrown out of the ground, again completely severing the pipeline. Repairs were quickly begun, using Grayco equipment still in the area. On January 17, 1969, the line had been completely repaired and was restored to operation.

As a result of these two ruptures, the United States Department of Transportation ordered the operating pressure on the line to be severely limited between the nearest compressor station on both ends of the Grayco section. Great Lakes undertook to make an internal examination, known as a Linalog survey of the portion of the pipeline which was now suspect.

While awaiting completion of the necessary preparations for the Linalog survey, Great Lakes sought and was granted permission to raise its operating pressure, although still not near its planned capacity. After the Linalog survey had been completed all pressure restrictions were completely removed, and the line began operating as planned on May 29, 1969.

When Great Lakes assumed possession of the line on November 1, 1968, it had changed its accounting proced-

ures from the "under construction" mode to an "in-service" mode. After the ruptures occurred, Great Lakes reverted to the "under construction" system until May 29, 1969. The effect of this reversion was to place all of plaintiff's costs during the period of repairs and pressure restrictions into its "plant" account, which was in turn used to determine its rate base by the Federal Power Commission.

The case was tried by a jury on three theories: negligence, breach of contract, and breach of implied warranty of fitness. Plaintiff submitted a total damage claim of $2,444,193.94 to the jury which returned a verdict as to all counts of $1,838,544.56, apparently reflecting a decision not to permit recovery of the revenue lost during the period of pressure restriction.

Defendant's first major ground for appeal is that the district court erred in permitting plaintiff to introduce certain opinion testimony as to the cause of the two ruptures. In this regard, defendant also charges error in permitting the Order of the Department of Transportation of January 17, 1969, to be introduced because it also is to have contained an opinion as to the cause of ruptures which is assailed as being hearsay. We do not believe that prejudicial error was committed in either instance.

The opinion testimony to which appellant refers is that of the witnesses Holstead and Etchegary. Holstead is the executive vice president and general manager of plaintiff. According to his testimony, he had been in the pipeline business for at least twenty years at the time of the ruptures. He also had nearly ten years' experience in the design, engineering and supervision of construction of gas pipelines while he was employed by TransCanada. While Holstead had a bachelor's degree in civil engineering, he

testified the he had acquired through his experience, a working knowledge of metallurgy and fracture mechanics. Moreover, it was uncontroverted that he had visited the sites of the two ruptures within hours after their occurrences and had examined the damaged pipe before it was removed. He testified at great length as to the specific facts which he personally discovered as to the type of fracture involved and its place of origin on the pipe. It was shown that the pipe had been badly gouged at the location of both ruptures and that this gouging had been inflicted after the welded pipe had been coated and wrapped, after the pipe had been laid in the ground and the ground filled in, and after the hydrostatic testing had been completed. Both sites were lowland areas which, because of the unusually wet weather, were soft and muddy. Heavy construction equipment was seen near both sites. Several witnesses saw a bulldozer driven back and forth across the pipeline itself, apparently while engaged in rough clean-up work.

With this foundation, Holstead was asked to give an opinion as to the cause of the pipe failure. Before he was permitted to answer, the trial judge cautioned the jury as follows:

> "The Court: Ladies and Gentlemen of the jury, I am going to permit the witness to answer the question.
>
> "What weight and credit you give to the testimony of a person who is qualified as an expert, that is a person who has some expertise beyond that which a normal person possesses, is up to you.
>
> "It depends upon his background and his own statement and knowledge and expertise in the area concerning which he purports to testify to.

> "Experts may give opinions, but the opinions may be considered by you only to the extent that you find the witness is qualified to act as an expert in that area and only insofar as it goes concerning factual matters forming the basis for his opinion which are established by other evidence or independent evidence in the case.
>
> "I will be instructing you more fully on this at the conclusion of the trial.
>
> "In the meantime I will permit him to answer the question and therefore the objection is overruled."

Holstead then testified that in his opinion the gouges were inflicted by mechanical means on the pipe. He was then asked to give his opinion as to what mechanical means could or would have inflicted the gouges. Over the objection of appellants and after voir dire examination outside of the presence of the jury, the court permitted Holstead to answer. Before answering, the court cautioned the jury that the question as to what actually inflicted the gouge was for the jury to decide. The trial judge said:

> "• • • The witness may testify from whatever expert knowledge he may have of the process as to what would or could have caused it, but the ultimate question of what caused it being one for the jury to decide."

The witness then answered that the gouging could have been inflicted by the pipe having been struck by some piece of heavy construction equipment. It is this opinion which appellant charges was prejudicial error.

In support of its contention, appellant cites the decisions in *Washburn* v. *Lucas,* 373 Mich. 610, 130 N.W. 2d

406 (1964); and *People* v. *Zimmerman*, 385 Mich. 417, 189 N.W. 2d 259 (1971), which it argues are controlling. In these cases the Michigan Supreme Court ruled that opinions of causation in negligence cases where the subject matter of the inquiry is of such a character that it may be presumed to lie within the ordinary experience of all men of common education, whether offered by experts or lay witnesses, are uniformly excluded as invasive of the province of the jury. It should be noted that both cases involved an opinion as to the cause of an automobile accident when there was already evidence before the jury in the nature of an eye-witness.

Putting aside the applicability of the maximum admissibility rule, Rule 43(a), Federal Rules of Civil Procedure, *Patterson* v. *Norfolk & Western Ry. Co.*, 489 F. 2d 303 (1973), we think these Michigan holdings are clearly distinguishable from the case at bar and therefore are inapplicable. As previously noted, the Michigan holdings are clearly distinguishable from the case at bar and therefore are inapplicable. As previously noted, the Michigan rule arose in the context of opinions by investigating officers as to the causation of an auto accident, a subject for which many, if not all, of the causal factors lie within the ordinary experience of all men and women of common education. We do not feel that the potential sources for gouging $\frac{3}{8}$" thick steel pipe, specially made to the gas transmission company's specifications, can be said to lie within the ordinary experience of most potential jurors. Hence, we find no error in the admission of Holstead's opinion testimony, particularly in view of the scrupulous cautionary instruction given by the trial judge.

What we have said applies with equal vigor to the similar testimony of the witness Etchegary. In any event,

appellant failed to make any objection at the time of Etchegary's testimony, thereby rendering it unavailable as grounds for appeal. *Hines* v. *Prudential Ins. Co.*, 357 F.2d 726 (6th Cir. 1966); *Tally* v. *Mitchell*, 275 F.2d 244 (6th Cir. 1960); *Bryant* v. *Sears, Roebuck & Co.*, 435 F.2d 953, 956 (4th Cir. 1970).

Appellants also argue that it was error to admit into evidence the January 17, 1969 order of the Department of Transportation in which the Acting Director of Pipeline Safety claimed to have met with representatives of plaintiff, the Michigan Public Service Commission and the Federal Power Commission for the purpose of deciding what regulatory measures were necessary in view of the two ruptures. The Director based his order in his letter, limiting the operating pressure in the gas pipeline of Great Lakes, on, *inter alia*, the following findings of fact:

> '5. Preliminary investigation indicates that this [the first] rupture resulted from external damage to the pipe during construction.
>
> '• • •
>
> '8. As in the case of the first rupture, preliminary investigation indicates that this [the second] rupture restated from external damage to the pipe during construction.
>
> '9. During the course of construction there were five test ruptures which resulted from prior external damage to the pipe."

Appellant argues that it was error to permit the jury to have these "findings of fact" in that they are hearsay, and bases his argument on *Derrick* v. *Blazers*, 355 Mich. 176, 93 N.E. 2d 909 (1959).

Appendix A

Plaintiff-appellee argues that the order was admissible under Rule 4 (a), Federal Rules of Civil Procedure. *See Patterson & Norfolk & Western Ry. Co., supra.* Moreover, Great Lakes argues that the defendant told the jury in its opening statement that the order was issued because the ruptures in the pipe had been lengthier than previously experienced. Grayco then contended that the pressure reduction which had been ordered resulted only because of doubts about the particular pipe used in constructing the pipeline and not because of anything Grayco had done. Therefore, it is argued, this statement sought to attack plaintiff's damage claim for revenue lost due to the order restricting operating pressure, and Great Lakes was thus required to show that the order had been issued without any reference therein to the length of the ruptures. Plaintiff also claims he offered the order for the purpose of showing the basis on which it acted in an effort to mitigate its damages since the order left open the chance of getting the restrictions lifted.

When defendant objected to the introduction of the letter, plaintiff explained to the court that it was being offered for the purposes previously outlined. The court then instructed the jury as follows:

> "This is one of those pieces of hearsay evidence that I was telling you about before you were sworn as jurors, after you were impaneled, ladies and gentlemen, where an exhibit can be received for one purpose. * * * This is the letter that directed [plaintiff to restrict its operating pressure]. To that extent it is admissible and proper, to prove what the Department of Transportation did. It contains, however, certain findings which are to be received by you only as the understanding of the

> writer of the reasons, but not as proof themselves of the reasons, or as truth of the facts therein. That has to come elsewhere in this trial, if it be true at all. But I am going to allow it to be received for the purposes set forth, not for the truth of the specific factual matters. You may consider that this is what the writer himself believed as the basis for his action, but not that those facts are in fact true.* * * ."

The witness was then permitted to read the letter containing the order to the jury.

We find no error in the admission of this letter. It bears repeating, in this context, that the hearsay rule excludes extra-judicial statements *only* when they are offered to prove the truth of the matter asserted. *Patterson Dental Supply Co.* v. *Wadley*, 401 F.2d 167 (10th Cir. 1968); *Carantzas* v. *Iowa Mut. Ins. Co.*, 235 F.2d 193 (5th Cir. 1956). Where, as here, the trial judge has carefully instructed the jury as to the purposes for which a letter containing hearsay may be admitted, and where there is substantial evidence elsewhere in the record bearing on the subject which is contained in the hearsay, we hold there is no prejudicial error in the admission of the letter. *Cf. Gray* v. *L. J. Navy Trucking Co.*, 475 F.2d 545, 550 (6th Cir. 1973).

The second major ground for appeal is that the court erred in excluding evidence, which appellant sought to introduce, that plaintiff has realized benefits which exceed its damages. After the two ruptures had occurred, plaintiff reverted to an accounting procedure whereby it was able to capitalize the costs of repairs as well as certain items, such as interest expense, which would nor-

mally have been charged as expenses deductible from income. Grayco thus argues that plaintiff's capital account, now containing the repair costs and other usual expense items, will be used by the Federal Power Commission to set the rates which Great Lakes will charge its customers and that these rates will be sufficiently higher so as to permit plaintiff to recapture these extraordinarily capitalized costs. But for the accident, plaintiff would have been unable to revert to the "under construction" mode of accounting, and therefore plaintiff realized a benefit which far exceeded its damages; or so it is argued.

In his opinion, the trial judge offered three reasons for excluding Grayco's evidence:

> 1) The public policy against permitting a wrongdoer either in tort or contract to pass the consequences of his wrong over to the public in general and thus escape responsibility for them;
>
> 2) The proof fails totally to show that, if any benefit was conferred, it was done so by defendant itself; and
>
> 3) The benefit itself is entirely conjectural and speculative.

While each of these reasons may be sufficient by itself, we feel that the first and last are particularly compelling within the context of this case. What appellant ignores throughout its argument on this point is that its position if accepted would mean that a tortfeasor should escape liability any time his victim can recover his damages from the general public. We do not read the relevant Michigan holdings to sanction such a policy. In *Motts* v.

Michigan Cab Co., 274 Mich. 437, 264 N.W. 855 (1936), the Michigan Supreme Court cited with approval the following:

> "• • • a defendant owes to the injured compensation for injuries the proximate cause of which was his own negligence, and that their payment by third parties cannot relieve him of this obligation, and whether the motive impelling their payment be affection, philanthropy, or contract the injured is the beneficiary of their bounty and not him who caused the injury." [quoting *Roth* v. *Chatlos*, 97 Conn. 282, 116 A. 332, 334 (1922)]. *Id.* at 858.

In *Motts*, the Michigan Court held that payment of a salary to an injured person by his employer during the time he is unable to work because of his injuries is not a ground for mitigation of damages to be paid by one who caused the injury. The plaintiff in *Motts* sought to recover, *inter alia*, loss of earnings even though his employer had continued his salary. Hence, we are of the opinion that the policies which underlie Michigan's collateral source rule operate to deny appellant's contentions as to the evidence it sought to introduce.

Moreover, it hardly needs showing that plaintiff operates in a highly regulated industry, and the rates it charges its customers are controlled by the Federal Power Commission. *See* 15 U.S.C. § 717 *et seq.* If it turns out that any recovery by plaintiff in this case would in effect be a double recovery because plaintiff had already been recovering damages through the rates it charges, then the Federal Power Commission has the power on its own to adjust plaintiff's rates accordingly. Therefore, any benefit allegedly conferred on plaintiff by de-

fendant is indeed conjectural and speculative since the Federal Power Commission could effectively take it away following any decision by this Court. We therefore conclude that the trial court's ruling on defendant's proffered evidence was not prejudicial error.

Finding no error in any of appellant's remaining contentions, we conclude that the judgment of the district court must be affirmed in all respects.

AFFIRMED.

APPENDIX B

Opinion of the United States District Court for the Western District of Michigan—Northern Division

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN—
NORTHERN DIVISION

MARQUETTE

GREAT LAKES GAS TRANSMISSION COMPANY,

Plaintiff,

v.

GRAYCO CONSTRUCTORS, INC., *et al.*,

Defendants.

File CA 1347

OPINION

In this case Mr. O'Brien seeks to cross examine John Phillip Sherwood, Treasurer of Great Lakes, concerning the accounting treatment of the repair costs and the general accounting methods employed by the plaintiff during the period in question. It is Mr. Sherwood's testimony, through the special record made on April 13, that in the first place the company's accounting is governed closely by requirements of the Federal Power Commission. This is no doubt true of utilities where rates

are regulated and based in large part upon the accuracy and methods of accounting employed. According to Mr. Sherwood phase I of the pipeline, that extending from Farwell to the middle of the St. Clair River had been and remained on an in-service basis well before the occurrences complained of here up to November 1, 1968. However, expenses incident to the construction of phase II had been calculated and placed into a work-in-progress account. Thus, according to Mr. Sherwood the expenses attributable to the phase II construction including an appropriate allocation of overhead, allocable interest, taxes, and the like were placed in an in-progress account and as of November 1, 1968 when the line was thought ready to go into operation, the amount as then calculated was placed in the capital or in-service account of the company, to be considered as a capital asset of the company (page 2016). Already $39,000,000 had been placed in the plaintiff's in-service account as an asset representing the cost of phase I. To this was added between $183,000,000 and $184,000,000, the cost of November 1, 1968 of Phase II.

During the in-construction phase of phase II, no depreciation was taken, but depreciation was generally allowed at a rate of 3% per year, that is, a 33-year life of the total line. At page 2017, Mr. Sherwood confirms that the Federal Power Commission has used net original cost for base rate positions. To this end, in early December, Great Lakes transferred $184,000,000 from the construction work in-progress account into the plants-in-service account effective as of November 1, 1968 when the T-4 contract was activated. He then confirmed that, following the second break and imposition of DOT pressure restrictions in January, phase II was placed back in the work-in-progress basis. Mr. Sherwood testified

that "It was the rupture that convinced us that the plant was not ready for service" (2019), and that "the ruptures resulted in the DOT restriction which further convinced us that the plant was not ready for service" (page 2020). Following the lifting of pressure restrictions, Phase II was restored to in-service status on May 31, 1969.

By fixing the change from in-progress to in-service at May 31, 1969 instead of November 1, 1968, a substantial change in the capital structure of Phase II was effected. For all practical purposes, this meant that all expenses incurred between those dates, including interest paid, overhead, property taxes and line break repair costs, (less revenues received) were added to the in-service plant account. It was Sherwood's estimate that during the period in question, approximately $8 million, representing the amount of interest which had been accrued on the outstanding debt between November 1 and the end of May, in consequence was added to the value of gas plant in-service, rather than being expensed as a charge against income.

It was Sherwood's further testimony that by remaining on an in-construction or in-progress position, there was further added the total line break costs and (in testimony on April 16) property and other state taxes on Phase II, as well as all line break costs. At the same time, no depreciation was, or could be taken during the period in question, a matter of around $4 million (2023) on annual rate of 3% (2022). Had Phase II remained in-service from November 1, 1968, the line break costs would have been added to plant costs, but the depreciation reserve would have been reduced by the original cost of the footage that was being replaced (2026). As it

was, both the original cost and repair costs were kept in the plant account.

Thus it can be seen that in adopting a May 31, 1969 date for change from in-progress to in-service, Great Lakes succeeded in effecting a substantial increase in its plant account. Since recovery by depreciation (2023) and also allowance for return on investment (2033) are based upon net original costs (2017), which in turn a determining criteria in establishing a rate phase with the Federal Power Commission, Mr. O'Brien for the defense seeks to argue that in the long run Great Lakes profited by the occurrence of the line breaks which made the extension of in-progress status possible. Any damage which might have been sustained, he argues, simply becomes not a loss, but an increase in the plant, and thus depreciable assets of the plaintiff to be fully recovered by rate increases covering the same.

From the foregoing, it can be seen how Great Lakes handled or sought to handle the transaction, but Mr. Sherwood indicates at page 2030 that personnel in the Federal Power Commission have questioned the propriety of adding this amount to the plant in-service account and thus using it as a base for long-range depreciation and also for rate charges. The testimony of Mr. Sherwood concerning rates is contained in pages 2031-2033. It is the sense of this testimony that Great Lakes did not apply for any increases in rates because of the line breaks as such. He did testify, however, that they did apply for an increase in the rates in the T-4 contract and the increase became effective on June 16, 1970, but that notwithstanding this and their ability to collect higher rates, they were at the end of each contract year obliged to refund down to the developmental rate

as specified in the T-4 contract and thus these monies over-collected were refunded to Trans-Canada. As of November 1, 1971, however, the developmental provisions of the contract expired and thus at that time Great Lakes had in fact established a higher price. Thus, after November 1, 1971, at least some increased rate was in fact reflected by the increased cost of the gas plant in-service by reason of the breaks and the accounting methods used although it was Mr. Sherwood's testimony that he did not apply for a "fully compensatory rate". (2033)

There was a suggestion in Mr. Sherwood's testimony, (although that is not fully developed and admissibility of his testimony at this stage seems to be uncertain in view of its hearsay nature), that the Federal Power Commission may disallow up to 8.5 million dollars of the in-service account which was added by reason of the change of the dates from November 1 to the end of May (2033). Mr. Sherwood's further testimony appearing at 2034 and 2035 is that it is the position of the Federal Power Commission that depreciation reserves should be adjusted to reflect the earlier in-service date of November 1 and that the staff recommended a reduction of approximately 8.5 million in the net carried value of the plant for its adjustment. Mr. Sherwood also testified that it was the Federal Power Commission's staff position on initial recovery in this lawsuit that it would be credited against plant account although there is no official order pending at the present time.

While the court at least now understands the facts better than it did earlier, it still is of the opinion that the theory of the defense espoused by Mr. O'Brien is untenable and evidence to support it is not admissible unless it serves some other valid purpose. There are at

least three valid reasons for this opinion. In the first place, there is public policy which speaks, I think, against permitting a wrongdoer either in tort or contract to pass the consequences of his wrong over to the public in general and thus escape responsibility for them. The second objection which I think is well taken in this case is that the proofs as elicited totally failed to show that if any benefit was conferred that in fact it is conferred by the tortfeasor himself. This has sometimes been the basis for allowing a mitigation or other adjustment, such as where the tortfeasor's own insurance policy provides medical payments in addition to liability coverage. In some states, although I do not believe Michigan, this has been treated as being a proper allowable deduction since the source of the compensation and benefits is directly from the tortfeasor. Such is not the case here because, in fact, at best the defendant only created the opportunity. It did not create the funds from which that benefit might be derived. The third reason why the court believes that such a claim is untenable is that which is suggested by Mr. Justice Holmes in *Southern Pacific* v. *Darnell-Taenzer Co.*, 245 US 531. That is that the benefit itself is entirely conjectural and speculative. Thus it is Mr. Justice Holmes' reasoning that where the tortfeasor is obligated to pay only for the foreseeable and proximate consequences of his act, by the same token he may not claim adjustment or deduction for benefits which are not necessarily foreseeable and which are conjectural in their nature. Regardless of what the Federal Power Commission may now plan to do or may have done in the past with respect to the treatment of the accounting period from November 1, 1968 to May 31, 1969, the fact remains that it is uncertain and unsettled and there appears to be some serious question about

what has now happened and what may happen in the future. To allow the defendant to take advantage of this circumstance and to argue that he is entitled to a credit for the conjectural future benefits which Great Lakes might receive would be to allow him the benefit of the conjectural and speculative future gains against damages which must be found by the jury as proximate and direct, and not speculative or conjectural. It would seem to me to be totally conjectural and in any event to say that whatever is done in this regard would actually result in a long range benefit to Great Lakes even if the position taken by Mr. O'Brien were correct. The purpose of Great Lakes in the operation of the business is to yield a return to its stockholders. Though it is a regulated industry, it is an industry nevertheless which is entitled to and is expected to operate at a profit for the benefit of its investors. While it may have been able to make some bookkeeping advantage by the method it has chosen, the fact is that, whenever the reason, it was shut down and deprived of the use of its investment, in whole or in part, for a substantial period of time. Nothing has been paid it in consequence of this loss, let alone from the defendant. Normally, most benefits accrue to a corporation tax-wise by being able to expense such losses rather than capitalizing them even though there may be insufficient current revenues against which to charge them. There still remains the possibility of carrying forward the provisions to apply against future income and thus reduce corporate income taxes proportionately to the benefit of the shareholders. Obviously there are many other considerations. In this respect I do not make any comment other than simply to show the highly speculative and, therefore, in my opinion, the highly improper nature of the defendant's claim in this

regard. It thus would be the opinion of the court that unless otherwise admissible testimony elicited to this effect ought not to be received by the jury.

There remains, however, serious question as to whether a good part of the testimony in the special could properly be excluded if it is in fact relevant to any other proper theory of defense or damages.

There are, in fact, at least two areas which the court can find would be legitimate and which would render admissible a good portion of the testimony sought to be elicited.

In the first place, Great Lakes in this trial so far has gone to great pains to emphasize to the jury the magnitude and expense and involvement of this project and to this end it has taken the trouble to lay out before the jury all of the circumstances surrounding the formation of the company, its corporate structure, as well as the development, construction and operation of the pipeline. It is apparent to this court from this and also from Mr. Jones' opening statement and inquiries to the jury on voir dire that Great Lakes hopes to convince the jury to think in terms large enough to warrant a verdict in the millions of dollars. This is directly stated by Mr. Jones at the commencement of this trial and also is implicit in the itemization of the damages which he seeks, which are now in excess of $2,500,000 according to his figures. Thus Mr. Jones has wanted the jury to think in large terms and has emphasized the magnitude of this project and gone into great detail concerning every phase of it. To this end it will be recalled as well that Mr. Rady himself, as Secretary and General Counsel for the corporation, testified that there was an approximate $300,000,000 investment tied up in the pipe-

line which was really the sole physical asset of the corporation and the sole purpose of Great Lakes' existence. It seems to me therefore that any evidence going to what the value actually is, or which might tend to establish that value as being less than claimed would be relevant. Thus it seems to me that it would be relevant to point out that phase II was, as Mr. Sherwood has testified, of a magnitude of approximately $184,000,000 and that the investment in phase I being $39,000,000 and that the total investment was something like $223,000,000 rather than $300,000,000 as stated by Mr. Rady. Since Great Lakes has seen fit to present to the jury so broad a picture, Grayco may also be permitted to pick up the same brush and paint a lesser one.

Even more important than this, Grayco is entitled to prove, if it can, that regardless of the line break, Great Lakes was in fact not really in a position to enter into full in-service operations at the time the line breaks occurred. It is a part of the claim of the defense that uncertainty over the suitability of the pipe itself was the major factor which caused the extended restriction on its use following the second line break. It is the claim of Grayco that the X-65 pipe and its composition here as manufactured by Stelco was highly experimental and that the pipe had characteristics which were unforeseen by its developers until the break themselves indicated that the ruptures could actually open the pipe up for such extended lengths. Thus, at least a major defense of Grayco is that in the first place there is absent any proof that the gouges were caused by Grayco employees; second, that if they were in fact caused by Grayco employees, they did not in fact cause the ruptures which were the result of other factors not the responsibility of Grayco and third, that it was the over-

all general properties of the pipe and not the possibility of further undiscovered damage by Grayco which prompted the DOT pressure restrictions. This is a fact question on which the court has no opinion, but which the court recognizes as being an area of legitimate inquiry by the defense. That Great Lakes may very well be able to rebut this by other competent evidence cannot prevent Grayco from trying to establish it. Grayco has agreed to the arithmetical calculations which are contained in Great Lakes' exhibits concerning the computation of revenue loss. Defendant has not, however, agreed that this revenue was in fact actually lost or would not have been lost, but for acts charged to it. The fact that Great Lakes did, following the line breaks, revert to a work-in-progress basis is admissible and relevant to any claim on the part of Grayco that in fact the pipeline was not ready to be placed into service and, therefore, that Great Lakes might not have obtained the revenue which it claims it lost due to the line breaks. Grayco is not bound to accept Great Lakes' reasons if there are others.

Thus, it is apparent to the court that while the major premise of Grayco is untenable, nevertheless, much of that information which it seeks to elicit may be otherwise relevant to its legitimate defense of the case. It also occurs to the court that to the extent that otherwise relevant evidence elicited by the defense may lead the jury into the forbidden territory, this can be cured by proper precautionary instructions. The court believes that it can, through proper exercise of its discretion, govern the admissibility of this evidence so as to protect legitimate rights of the defendants and yet avoid improper speculation and conjecture by the jury. The exact line can only be drawn as the question is asked,

but in general, the court is of the opinion that the defense can elicit testimony as to the cost of the project, as to the accounting methods used. The court believes it would be improper to elicit proof, from Mr. Sherwood or otherwise, concerning subsequent rate increases allowed or possibly allowable on the basis of the increase in the plant account arising from the change in accounting method. Even though there may be some slight relevance, the issue is primarily collateral and would necessarily open the door to an extended effort by plaintiff to counter it. The court is of the opinion that it possesses the power to confine the proofs, and the length of the trial, within reasonable bounds.

One further comment and this concerns Mr. Jones' statement that if the testimony sought by Mr. O'Brien were injected into the trial, it would be so prejudicial as to warrant a motion for a mistrial. While of course the court would have to reserve its judgment on this until the event itself, it does not appear from what I now know of the expected testimony that any error made in this regard would be incurable. If, after the testimony is heard, and I know what goes before the jury, it appears that an improper inference could be made by the jury, I believe it would be entirely adequate to instruct them that they could not diminish any damages otherwise allowable by reason of rate increases which might be granted to cover the loss. They are, of course, a part of the very public which would be penalized were such a rule to be employed and I cannot conceive that they would look favorably toward such an argument, especially if the court itself were clearly to tell them that they should not.

One area not covered in this preliminary opinion is what the proper law would be, should the jury find that

the line breaks themselves were properly repaired shortly after they occurred, but that the fact of the breaks triggered an investigation which went solely to the adequacy of the line in view of its experimental nature if the proofs so show. This is a question of proximate cause and of intervening cause and one on which I am not prepared to make any comments at this time.

(s) ALBERT J. ENGEL
Albert J. Engel
District Judge

Dated: April 17, 1973

APPENDIX C

Great Lakes' Benefits Resulting from the Line Breaks

At the time of the line breaks, Great Lakes was providing service to customers under the terms of certain contracts which provided, among other things, that there would be no increase in rates until at least November 1, 1971. Prior to that date, Great Lakes asked the Federal Power Commission for a rate increase in Docket No. RP 71-102. After being granted a rate increase effective November 14, 1971, another rate increase was requested in Docket No. RP 73-4. A further rate increase was granted effective February 4, 1973.

Our analysis of schedules and reports filed with the Federal Power Commission in the two rate cases referenced above indicates that the rates which Great Lakes has been permitted to charge its customers has been based on the sum of the following anticipated amounts prorated to its various customers in a systematic manner: (1) Operation and maintenance expenses; (2) Depreciation expense; (3) Federal and state income taxes; (4) Other taxes; (5) Amortization of Other Gas Plant Adjustments in RP 73-4; and (6) A return of a certain percentage on the rate base.

Under Item (6) above, the rate base is made up of amounts recorded in "Gas Plant In Service" accounts and "Construction Work In Progress" accounts, less amounts recorded in "Accumulated Provisions For Depreciation of Gas Plant In Service" accounts. Other items making up the rate base are working capital and accumulated deferred income taxes. The rate of return takes into account the cost of borrowed funds and a return on equity, and was set at 9.5% in the Settlement Agreement in RP 73-4. Under RP 71-102, the rate of

return changed quarterly depending on the cost of borrowed funds, since Great Lakes borrowings were in the form of bank debt at the time RP 71-102 rates became effective.

Based on the data available to us, we have estimated that as a result of the line breaks, the in-service date for Phase II facilities being initially considered to be May 31, 1969 and finally January 31, 1969 rather than November 1, 1968, and the resulting accounting changes, Great Lakes has been permitted to recover $2,245,064 to December 31, 1974, from its customers by means of higher service rates.*

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* This estimate is made up of the following items:

1. An increased rate base including operating expenses, interest during construction, less operating revenues, and depreciation not recorded during the period November 1, 1968 through January 31, 1969. Also included in the increased rate base are the direct costs of repairing the two line breaks.
2. During the period November 14, 1971 through February 3, 1973 rates were based on a rate base which additionally included the amounts removed from the rate base in the Settlement Agreement in RP 73-4.
3. Depreciation expense recorded on the increased amounts included in "Gas Plant In Service" accounts.
4. Since February 4, 1973, the amortization over ten years of amounts removed from the rate base in the Settlement Agreement in RP 73-4.
5. Since February 4, 1973, a tax benefit assuming no tax basis adjustment relating to the original cost adjustment provided for in the Settlement Agreement in RP 73-4.

Appendix C

Based on present rate making formulas, Great Lakes can anticipate continued increased revenues over the remaining depreciable life of its Phase II facilities, which is approximately 20 years. We estimate the annual benefit under RP 73-4 as follows:

Increase in rate base	$2,325,412
Increase in return at 9.5%	$ 220,914
Amortization of rate base adjustment over ten year period November 15, 1971 through 1981	503,894
Tax benefit assuming no tax basis adjustment relating to original cost adjustment	(110,262)
Depreciation on increased plant at cost	34,984
NET ANNUAL BENEFIT	$ 649,530

Appendix C

Schedule 1

Estimated Increase in Revenues Realized Due to Line Breaks—to December 31, 1974

	Rate Base	*Rate of Return*	*Increased Revenues*
Rate Formula In RP 71-102			
Increase in rate base due to the line breaks—Schedule 2	$7,625,267		
Increase in return as a result of increased rate base:			
November 14 through December 31, 1971		9.55%	$95,765
January 1 through March 31, 1972		8.86	167,977
April 1 through June 30, 1972		8.52	161,531
July 1 through September 30, 1972		8.86	169,823
October 1 through December 31, 1972		9.50	182,090
January 1 through February 3, 1973		9.50	67,478
TOTAL INCREASE IN RETURN			844,664
Increase in cost of service as a result of increased depreciation expense recorded on increased plant at cost ($4,348,633 X 3% X 14½/12)			157,638
TOTAL—RP 71-102			1,002,302

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	Rate Base	*Rate of Return*	*Increased Revenues*
Rate Formula In RP 73-4			
Increase in rate base due to the line breaks—Schedule 2	$2,325,412		
Increase in return as a result of increased rate base—February 4, 1973 through December 31, 1974		9.50%	421,250
Increase in cost of service as a result of increased depreciation expense recorded on increased plant at cost ($932,901 X 3¾% X 23/12)			67,052
Increase in cost of service as a result of amortization of rate base adjustments over ten years ($5,038,937 X 10% X 23/12)			965,796
Decrease in cost of service as a result of tax benefit assuming no tax basis adjustment relating to original cost adjustments ($3,415,732 X 81.1% X 3.75% X 1.061431 X 23/12)			(211,336)
TOTAL—RP 73-4—TO DECEMBER 31, 1974			1,242,762
TOTAL ESTIMATED INCREASE IN REVENUES REALIZED DUE TO LINE BREAKS TO DECEMBER 31, 1974			$2,245,064

Appendix C

Schedule 2

Estimated Increase in Rate Base Due to the Line Breaks

	Plant At Cost	*Accumulated Depreciation*	*Net Increase (Decrease)*
Amounts capitalized as of May 31, 1969 as a result of line breaks Schedule 3	$4,348,633	$ —	$4,348,633
Depreciation not recorded from November 1, 1968 through May 31, 1969 ($199,039,632 X 3% X 7/12)	—	3,483,194	3,483,194
TOTAL AS OF MAY 31, 1969	4,348,633	3,483,194	7,831,827
Depreciation recorded to December 31, 1970 ($4,348,633 X 3% X 19/12)	—	(206,560)	(206,560)
TOTAL AS OF DECEMBER 31, 1970 AND INCLUDED IN RATE BASE IN RP 71-102	4,348,633	3,276,634	7,625,267
Depreciation recorded in 1971 and 1972 ($4,348,633 X 3% X 2)	—	(260,918)	(260,918)

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	Plant At Cost	*Accumulated Depreciation*	*Net Increase (Decrease)*
Net expenses capitalized for period February through May 1969—Schedule 3	(124,699)	—	(124,699)
Property taxes capitalized—Schedule 3	(3,291,033)	—	(3,291,033)
Provision for depreciation deficiencies for the period February through May, 1969 ($199,039,632 X 3% X 4/12)	—	(1,990,396)	(1,990,396)
Reversal of depreciation recorded for the period June, 1969 through Dec. 1972 ($124,699 + $3,291,033 X 3% X 43/12)	—	367,191	367,191
TOTAL ADJUSTMENTS	(3,415,732)	(1,623,205)	(5,038,937)
TOTAL ESTIMATED INCREASE IN RATE BASE DUE TO THE LINE BREAKS AS OF DECEMBER 31, 1972 (As Adjusted In Settlement Agreement and Included In Rate Base In RP 73-4)	$932,901	$1,392,511	$2,325,412

Appendix C

Schedule 3

Estimated Amounts Capitalized as a Result of the Line Breaks

November, 1968—May, 1969

	November 1968	*December*	*January 1969*	*Total 3 Months*
Net Expenses Capitalized—				
Revenues	$(1,194,809)	$(1,545,653)	$(941,044)	$(3,681,506)
Interest during Construction	1,061,596	1,109,829	1,190,640	3,362,065
Cost of Gas Sold	97,100	183,625	250,601	531,326
Operating Expenses	10,863	71,005	89,563	171,431
NET AMOUNT	$ (25,250)	$ (181,194)	$ 589,760	$ 383,316

	February	*March*	*April*	*May*	*Total 4 Months*	*Total Capitalized*
Net Expenses Capitalized—						
Revenues	$(1,637,082)	$(1,756,412)	$(1,806,312)	$(1,821,267)	$(7,021,073)	$(10,702,579)
Interest during Construction	1,189,810	1,283,785	1,416,478	1,417,235	5,307,308	8,669,373
Cost of Gas Sold	311,129	327,560	328,800	252,960	1,220,449	1,751,775
Operating Expenses	147,296	164,842	150,783	155,094	618,015	789,446
NET AMOUNT	$ 11,153	$ 19,775	$ 89,749	$ 4,022	$ 124,699	508,015
Property Taxes Capitalized						3,291,033
Line Break Costs Capitalized						549,585
TOTAL						$4,348,633

NOTE—Net Expenses capitalized for the period February through May, 1969 and property taxes capitalized were subsequently reclassified to F.P.C. Account No. 116, "Other Gas Plant Adjustments", and amortized over 10 years beginning November 15, 1971 according to Settlement Agreement entered May 8, 1973 in rate case RP 73-4.

Appendix C

Schedule 4

Estimated Increase in Future Revenues Due to Line Breaks—From January 1, 1975

Increase in rate base due to the line breaks —Schedule 2	$2,325,412
Remaining life as of January 1, 1975—approximate	20 years
Increase in return as a result of increased rate base—20 years at 9.50%	$4,418,283
Increase in cost of service as a result of increased depreciation expense recorded on increased plant at cost ($932,901 X 3¾% X 20 years)	699,680
Increase in cost of service as a result of amortization of rate base adjustments over period extending through November 15, 1981 ($503,89x X 6 10.5/12)	3,464,271
Decrease in cost of service as a result of tax benefit assuming no tax basis adjustment ($110,262 X 20 years)	(2,205,240)
Total from January 1, 1975	$6,376,994
Total to December 31, 1974—Schedule 1	2,245,064
Total Estimated Increase in Revenues due to line breaks	$8,622,058